



SMID Select Opportunities

Portfolio Comments

June 30, 2019

Distinguishing Features

GIM builds the [SMID Select](#) portfolio from the bottom-up; sector weightings are secondary to stock selection. As of 6/30/2019, the portfolio continues to have a significant overweight position in the energy sector, now 10% versus 2% for the Russell 2500 Growth benchmark. Healthcare has also moved to an overweight position at nearly 30% versus 22% for the Index. The overweight position in Industrials continues, 22% versus 17%. Consumer discretionary remains the largest underweight to the benchmark, 6% versus 15%. Info tech has also moved to an underweight position at 21% versus 26%. The portfolio has no exposure to materials, where the benchmark has a 4% weighting. Financials are also 4% underweight the Index, at 3% versus 7%. All other sectors are within 2% of the benchmark weighting.

Commentary

Market Environment

During second quarter of 2019, the market changed courses each month. April returns were buoyed by the strong corporate earnings reports. May was marked by intensified trade wars with Mexico and China, and the markets were down sharply. June posted a rebound, reflecting strong consumer spending and the possibility of a future interest rate cut by the Fed. The Russell 2500 Growth Index ended the quarter up 4.1%, with a year-to-date return of 23.9%.

Performance Discussion

For the quarter, the SMID Select strategy composite outperformed with a return of 6.1% net-of-fees. Year-to-date, the strategy remains behind the benchmark with a return of 21.9% net-of-fees. In the quarter, strong stock selection in the industrials and healthcare drove performance, with our overweight position in each boosting relative performance. Selection in real estate and communication services also assisted relative performance. The portfolio's large overweight position in energy was a negative, as was selection, resulting in energy as the largest drag to performance in the quarter. Selection in consumer discretionary, info tech, and financials also weighed on performance.

With respect to LifeCycles, the portfolio's Core Growth holdings drove performance, while Pioneer names also outperformed the overall benchmark. Special Situations had a negative return overall, and weighed on the quarter's performance. Three Core Growth holdings were among the top five in the quarter: Enphase Energy (industrials), Exact Sciences (healthcare), and Euronet Worldwide (info tech). Two Pioneers rounded out the top five: Kornit Digital (industrials), and Medicines Company (healthcare).

On the negative side, two Special Situation energy holdings detracted in the quarter: Ring Energy and Carrizo Oil & Gas. Other holdings in the bottom five for the quarter include Stamps.com (consumer discretionary, Core Growth), 2U (info tech, Pioneer), and Evolent Health (healthcare, Pioneer).



Positioning

The market continues to reward high growth stocks. Secular growth, in particular, is highly prized in a low-to-no-growth world. We believe this may persist. We entered 2019 at the high-end of our desired range (20%-40%) for Special Situation stocks, many of which represent companies that exhibit accelerating sales and earnings growth, but not necessarily high levels of either. Special situation holdings, overall, have not done well this year. We have lowered our position in this LifeCycle category to 26% from 36% at the beginning of 2019.

While the Core Growth weighting has increased slightly from 42% to 44%, Pioneers have gained more significantly with several additions, now 29% versus 22% at the beginning of 2019. We have been actively adding to our weighting in Pioneer biotechs, capitalizing on the sector expertise and vast experience of GIM's biotech analysts. Recent additions include argenx SE and Immunomedics. With the biotech weighting now at 9% of the Russell 2500 Growth Index, our 16% position represents an overweighting that we believe will continue given the innovation and prospects this area represents.

Outlook

While growth is generally scarce across the economy, we believe that the outlook for the companies in the SMID Select portfolio is very good. Across the LifeCycles, our companies are, in general, experiencing excellent growth that we believe can be sustained for the foreseeable future, as they are poised to capitalize on substantial long-term opportunities or are beneficiaries of company-specific dynamics. Companies in the portfolio are market leaders or gaining market share, and many of them are also leaders in terms of innovation and market disruption.

In comparison to small cap value stocks, small cap growth stocks are trading at premium valuations (based on current earnings), and we believe that this may persist for some time given the dynamic opportunities available to many of these companies. Company fundamentals drive our bottom-up excellent stock analysis and decision making, and diversification across the three LifeCycle categories – each with distinct performance drivers – balances the portfolio. Both are important to the long-term consistent performance of the SMID Select strategy.

Disclosure:

The information provided in this commentary should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings.

It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.